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SUBJECT: COFFEE EXPORTS FALL AS GOE TIGHTENS GRIP ON MARKET

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SENSITIVE BUT UNCLASSIFIED; BUSINESS PROPRIETARY INFORMATION; NOT
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SUMMARY

11. (SBU) The government of Ethiopia (GoE) established a new coffee quality control and marketing law (amended August 25, 2008) in order to enhance its control of the domestic coffee sector and carve out a new strategy for increasing coffee exports. However, over the last eight months, the new law has been met with stiff resistance from private coffee exporters and has also coincided with a marked decline in the value and volume of exported Ethiopian coffee. It appears that opposition to the new law by coffee exporters coupled with persistent backwards farming methods, opaque trading practices, unfavorable climatic conditions during the last harvest and finally softening global demand continue to stifle the GoE's export-led strategy and ability to earn critically needed foreign exchange earnings (Reftel).

12. (SBU) As authorized by the recently amended coffee law, the GoE tasked the less than one-year-old Ethiopian Commodity Exchange (ECX) with the primary responsibility for managing the pricing and flow of exported Ethiopian coffee. However, since its inception, the ECX has drawn the ire of coffee exporters for contributing to delays and inefficiencies in their transaction and product delivery systems. While the GoE has taken a more active role in managing the coffee sector, it is unclear at this stage how effectively it can enforce the law and how the coffee market, which includes a long list of middle-men and disgruntled exporters, can rationalize the role of the ECX and the GoE's long-term goals for the sector. END SUMMARY.

BACKGROUND

13. (U) The amended coffee law and the ECX's establishment have modernized the coffee trade in Ethiopia and have leveled the playing field across the supply chain. A modernized ECX now has a clear

mandate by the GoE to rationalize a fractured coffee market prone to pricing asymmetries and a declining volume of product slated for the export market. Close to 50 percent of coffee produced in Ethiopia gets sold to the domestic market often at prices well above world prices. The GoE hopes to enhance the effectiveness of the coffee supply chain, which should increase the value and volume of its coffee exports and hopefully improve earnings parity among stakeholders along the supply chain. The GoE has taken the fractured coffee sector supply chain head-on because coffee is the backbone of the GoE's export-led growth strategy. Coffee contributes 35 percent (USD 525 million) of the country's annual export receipts and is also the mainstay of close to 15-20 million coffee sector farmers, traders and exporters. Smallholder farmers produce over ninety-five percent of the total coffee production while the remaining is produced by government and private commercial farms. (Note: The GoE has also included a provision in the amended law for farmers and producers to export directly to the global markets, essentially bypassing the ECX. However, it's uncertain if the GoE will ultimately allow this provision to work since many farmer co-ops are still waiting for their licenses).

COFFEE TRADE: A HISTORY OF NEGLET

14. (U) The GoE has only recently begun to pay close attention to the mechanics and potential of its coffee crop. In the past, the coffee trade seemingly functioned amid a dizzying array of middlemen, disparate farms and an ill-prepared and organized government regulatory body. In the last decade, the coffee sector has been shifted from varying government agencies and primary responsibility for the sector has not always landed in the places with the best technical capacity or resources to manage the industry. Over the last several years, the Ethiopian Intellectual Property Office has

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had the responsibility of managing the coffee sector budget and intellectual property trademarks for Ethiopia's specialty coffee market. There is currently no governing office for the coffee sector within the Ministry of Agriculture and Rural Development. Although the established trademarks for Ethiopian coffee (Sidamo, Yiragchefe and Harar coffees) have been a victory for the GoE and the coffee sector in Ethiopia, unfortunately, the major budgeting and regulatory functions for the coffee sector have been underfunded and ill-managed. In addition, the coffee sector suffered from severe information asymmetries among farmers, suppliers and exporters, resulting in poor pricing schemes and limited profitability for farmers along the supply chain.

GOE TIGHTENS GRIP ON COFFEE MARKET

15. (U) Over the past year, the GoE has tightened its hold on a coffee market that, in spite of its leading role as the primary foreign exchange earner, has failed to live up to its potential. In August 2008, the Ethiopian Parliament passed a new Coffee Quality Control and Marketing law (Proclamation No 602/2008), 64 years after the first coffee law took effect, in order to fix the fractures in the current market. Implementing a key provision of the law in early December 2008, the GoE halted the old and inefficient coffee auction markets and appropriated primary auction responsibilities to the newly established ECX. ECX, a modern trading operation, which relies on standard coffee contracts and new automated systems, seeks to establish standard parameters for coffee grades, transaction size, payment, delivery, trading and order matching while preserving distinctive coffee origins and types. ECX, unlike the previous auction market system, is high-tech and much more concerned with quality control and inspection of coffee products slated for the export market. Coffee is now traded as washed or unwashed and bears a label of its region of origin and grade. It may also include a 'type' or new categorization denoting a sub-region in a specific coffee growing area. The ECX will now require that all trades be based on warehouse receipts issued to depositors rather than on a sample basis as was done in the past. Coffee buyers can then take delivery of their coffee product at ECX warehouses with their

ECX-issued warehouse receipts.

NEW COFFEE LAW LEVELS PLAYING FIELD?

¶16. (U) In a market where profits are not shared evenly across farmers, traders and exporters, the GoE's updated coffee law is an attempt to level the playing field throughout the supply chain in the highly profitable coffee business. The law levels the playing field in the coffee sector by providing transparent price discovery, enhanced supply and regulated storage of coffee products via the ECX. Now coffee farmers and suppliers can be assured of stable and transparent prices through the ECX's primary auction center in Addis Ababa. The ECX allows buyers and sellers to negotiate prices openly while New York global mercantile coffee prices flash on the many monitors of the auction floor. The updated law closes the information gap between the largely uneducated small holder farmers and the wealthier urban traders and exporters. Farmers now have access to updated coffee prices through the ECX's main auction center and via several pricing clocks which have been set up by the ECX around the country. Also, the ECX has taken on the role of warehousing the coffee stock provided by suppliers in order to improve storage standards and supply consistency in the market. Coffee buyers can now be assured of more supply consistency and volume of coffee slated for the export market. Once a trade has been completed at the ECX, buyers can pick up their appropriate stocks of coffee at the various ECX bonded warehouses.

¶17. (U) The GoE also hopes to deter traders and coffee sector participants from skirting the new law and role of the ECX by assessing heavy fines and threats of imprisonment. Stakeholders involved in the domestic coffee business will now face much stricter penalties than in the past, such as up to ten years of imprisonment and USD 10,000 in fines for not abiding with the new regulations. Mr. Abdellah Bagersh, Manager of a very well established, Addis

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Ababa-based coffee company, Bagersh Coffee PLC, noted that the law's focus on the elimination of illicit coffee trade practices and punitive measures are appropriate for the health and viability of the market. According to Bagersh, the law addresses the preceding law's inability to facilitate a more open and transparent market over the last seventeen years. Bagersh is optimistic that the law will help Ethiopia to maximize foreign exchange earnings from the sector while protecting the interests of small-holder farmers.

GOE PENALIZES KEY COFFEE EXPORTERS

¶18. (U) On March 25, 2009, local media outlets reported that the Ministry of Agriculture and Rural Development suspended trading licenses of 94 coffee exporters including top export earners, which include Mulege Private Limited Company, Kemal Abdela International, ¶19. Sara coffee exporter, Legese Sherefa Ltd., Said Yassin Ali exporter and Ershere Ltd. This group of six top exporters made up the lion's share of Ethiopia's coffee export activities (70 percent of the total export) in 2008. With the GoE desperate for hard currency, the Ministry cracked down on exporters who were delaying exports by holding stock until world coffee prices increase. The GoE action follows a stern warning issued March 3, 2009, from Agriculture Minister Tefera Derbew that all coffee exporters needed to sell their existing coffee stocks to the export market by March 10, 2009 or face significant penalties such as fines, licensing bans and imprisonment. Apparently, exporters have only exported roughly 28 percent of the stock purchased via the ECX and are holding the remaining stock until world prices rise. As recently as April 5, 2009, local media reported that the state-owned Ethiopian Grain Trade Enterprise set plans to begin exporting the seized coffee stocks within a week of the announcement in order to fill the current supply gap. The GoE has not indicated how long the Grain Trade Enterprise will attempt to fill this gap or how much additional share of the export market they will try to capture over time. To date, private companies have controlled the bulk of the coffee trade, while the government has taken a backseat.

ECX AND WEAK DEMAND TO BLAME, SAY EXPORTERS

¶9. (U) Exporters point to the ECX's inefficiency and the falling global demand and prices as the major culprits behind the real declines in coffee exports from Ethiopia. Critics contend that the GoE has come down too hard on exporters for allegedly hoarding coffee. Penalized exporters and coffee sector experts claim that the recent government action to ban the licenses of several large coffee exporters from trading may destroy the business of these banned exporters and ultimately will exacerbate the acute supply gap in the coffee market. They say that the new coffee legislation does not explicitly address the roles and responsibilities of critical stakeholders in the coffee market and has left major supply gaps in the market. Although optimistic about the law, coffee exporter Abdellah Bagaresh noted the absence of any awareness or educational campaigns by the GoE on the precepts and goals of the law in either its previous or amended form. Bagaresh suggested that coffee stakeholder training and workshops should have been developed in tandem with the passage of the amended coffee law. Moreover, important coffee sector participants were not given adequate time to provide feedback to the GoE on the proposed amendments to the 60 year old coffee law.

¶10. (U) In addition to waning global demand for Ethiopian coffee, allegations of theft along the supply chain remain rampant. Although now proven to be unfounded, local Ethiopian press reported on January 25, 2009 that up to 10,000 tons of coffee (worth about USD 20 million) set for the export market had vanished recently from the ECX's bonded warehouses. Ethiopia exports roughly 150,000 tons of coffee per year. The allegation of missing coffee set the Prime Minister on a collision course with coffee exporters and the ECX. In response to this loss, the Prime Minister said the GoE would "cut the hands of those committing grave crimes against the country as of January 9, 2009." However, the head of the ECX, Eleni Gebre-Medhin, has consistently maintained that the allegations of lost coffee and

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exporter complaints of delays at the ECX have been untrue and completely unfounded. Dr. Eleni attributes the recent flurry of negative reports in the media regarding the ECX's role in the coffee market to manipulation of the media by exporters spreading false rumors. Eleni alleges that exporters have been unwilling to comply with the new ECX system and remain angry over the increased trading costs such as the doubling of storage fees to 11 cents per bag per day at ECX warehouses for coffee purchased at the ECX. (Note: In order to improve transparency in the ECX's auction market, the GoE has required the ECX to warehouse all coffee stocks provided by local suppliers before sale and delivery to exporters).

SPECIALTY COFFEE NOT ADDRESSED IN LAW

¶11. (U) The GoE has not addressed specific treatment for the small but important share of export coffee known as 'specialty' or 'organic' coffee at the ECX. Currently, the ECX only accommodates roughly nine of the dozens of specialty coffee types at its auction center and does not distinguish between specific coffee growers. Also, despite numerous efforts to market (per increasing international demand) bird-friendly, forest-grown, specialty and organic coffees from Ethiopia, there is no legislative framework that explicitly recognizes or regulates this segment of coffee in terms of certification, accreditation or monitoring. While organic coffee is attached to some legislation, it has yet to have a publicly recognized certification system via the ECX. Both organic and specialty coffees lack a public/private third party certification body to source officially information on market trends and volumes. Acting Director General of the Ethiopian Intellectual Property Office (EIPO), Alemu Abebe, shared with EconOff that challenges persist in the specialty coffee branding and marketing arena, such as reaping additional profits from international buyers of trademarked Ethiopian coffee and ensuring consistent quality along the supply chain. Ethiopia enjoys a comparative advantage in

the specialty coffee arena, particularly because exporters can fetch much higher prices in the world markets. To date, Ethiopian coffee makes up a modest two percent of the world coffee market.

COMMENT

¶12. (SBU) The new coffee law is a major step forward by the GoE to improve the supply chain, price scheme and earning potential of exported coffee. As a result, the ECX now manages the major distribution and pricing functions of coffee trade and tries to address the decades of GoE inattention to the sector and severe technological and information gaps along the supply chain. Although the law is a step in the right direction, the GoE should continue to encourage overall market efficiency, and provide additional financial support to the ECX for increased product differentiation and targeted responses to specialized global coffee market demands. The ECX does not provide, as of yet, a full suite of coffee varieties, grades and a high level of product differentiation. Incidentally, international buyers continue to lament the lack of specialized coffee varieties and the inability of the ECX to identify desired coffee product from favored growers. The newly amended coffee law does not significantly address the ECX's limited capacity and market breadth, and certainly does not deal with the external impediments to the coffee sector such as declining world demand for coffee and deleterious climatic patterns. Lastly, the GoE's recent and public clamp down on coffee exporters for allegedly hoarding stock has imperiled the sector's already fragile supply chain and may have signaled the GoE's move to capture a larger share of the lucrative market. END COMMENT.

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